

## **Pensions Committee**

**17 March 2021**

### **Treasury Management Report**

#### **Report by Director of Finance and Support Services**

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#### **Summary**

The Director of Finance and Support Services recommends a continuation of the current treasury management strategy in 2021/22 (as originally approved by the Pensions Committee at their January 2020 meeting) with internally managed investments only being deposited into high creditworthy banks (that offer instant access bank account facilities) and a series of high creditworthy short-term (instant access) Money Market Funds, with one amendment reflecting current market conditions:

- i. Approval of short-term Money Market Funds that operate under a Variable Net Asset Valuation, when a change from a Low Volatility Net Asset Valuation is adopted by the fund to allow continual and effective operation in a (or potential) negative interest rate environment.

Given the strategy of maintaining a highly liquid investment portfolio held exclusively in bank unsecured deposits, the Pension Fund's internally managed cash will remain subject to bail-in risks under UK Banking Directives.

#### **Recommendations**

- (1) The Committee approves the 2021/22 Treasury Management Strategy as set out in Appendix A.
  - (2) The Committee notes the treasury activity undertaken during 2020/21 (1 April to 31 December 2020).
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### **Treasury Management Report**

#### **1 Background**

- 1.1 The CIPFA "Treasury Management Code of Practice" requires the West Sussex Pension Fund to determine a treasury management strategy on an annual basis regarding the investment of its internally managed cash balances. The strategy includes the "Annual Investment Strategy" (AIS) that is a requirement of the Ministry of Housing, Communities and Local Government's (MHCLG) "Investment Guidance" .

- 1.2 The CIPFA Code also requires reports detailing compliance and performance against approved treasury strategies to be reviewed by the Pensions Committee.

## 2 Economic Summary

- 2.1 The coronavirus outbreak has done huge economic damage to the UK and economies around the world. After the Bank of England (BOE) took emergency action in March 2020 by cutting the Bank Rate from 0.75% to first 0.25% and then to 0.10%, it then left Bank Rate unchanged at its meetings throughout the remainder of 2020. Following the historic fall to UK Gross Domestic Product (GDP) during the first national lockdown period, growth recovered sharply in June through to August although remaining below pre-pandemic levels. The last three months of 2020 are likely to show no growth as further national restrictions were announced due to rising coronavirus cases, consumers remained cautious in their spending and uncertainty remained over the outcome of the UK/EU trade negotiations concluding at the end of the year. Going forward, with rising global infection rates (albeit dependant on the rollout of vaccination programmes) the pace of UK recovery is not expected to be in the form of a rapid V-shape, but a more elongated and prolonged one.
- 2.2 Regarding UK employment and inflation forecasts, a key addition to the BOE's forward guidance was that "it does not intend to tighten monetary policy until there is clear evidence that significant progress is being made in eliminating spare capacity and achieving the 2% inflation target sustainably". Effectively this suggests that there will be no action taken to raise the Bank Rate from current levels until it can be clearly demonstrated that the level of inflation is remaining persistently above target. As a result, the following table gives West Sussex County Council's treasury management advisor's (Link Group) central view for the path of UK Bank Rate over a three year horizon (updated November 2020):

Rate (%)	Mar 2021	Jun 2021	Sep 2021	Dec 2021	Mar 2022	Jun 2022	Sep 2022	Dec 2022	Mar 2023	Jun 2023	Sep 2023	Dec 2023
UK Bank Rate	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10

- 2.3 Negative Interest Rates: While the BOE said in August and September 2020 that it was unlikely to introduce a negative Bank Rate (at least in the next 6 months), as the end of 2020 approached markets as a whole saw an increasing swathe of monies being focused on ultra-short investment periods; thereby placing downward pressure on yields. This saw several market operators (including HM Treasury) offering nil or negative rates for very short term maturities. Additionally, short-term money market funds (MMFs) which had been offering a marginally positive return (albeit by a reduction in the fees charged) saw rates fall to between 0% to 0.01% by the close of 2020. As year-end positioning begins to unwind in early 2021 so the amount of money weighing on short-term yields should begin to dissipate. However, underlying interest rate expectations, bank regulatory requirements and investor liquidity needs will still combine to ensure that short-term investment rates remain at very low levels in 2021.

### **3 Treasury Management Strategy (2021/22)**

- 3.1 The Director of Finance and Support Services recommends a continuation of the current treasury management strategy in 2021/22 (*as originally approved by the Pensions Committee at their January 2020 meeting*) with internally managed investments only being deposited into high creditworthy banks (that offer instant access bank account facilities) and a series of high creditworthy short-term (instant access) Money Market Funds; subject to one amendment (below):
- (i) Approval of short-term Money Market Funds that operate under a Variable Net Asset Valuation, when a change from a Low Volatility Net Asset Valuation is adopted by the fund to allow continual and effective operation in a (or potential) negative interest rate environment.
- 3.2 Given the strategy of maintaining a highly liquid investment portfolio held exclusively in bank unsecured deposits, the Pension Fund's internally managed cash will remain subject to bail-in risks under UK Banking Directives (which regulates that unsecured investors in a failing bank, including local authorities and local authority pension funds, would be liable in rescuing the bank instead of UK taxpayers).
- 3.3 The recommended 2021/22 Treasury Management Strategy is attached at Appendix A.

### **4 Treasury Management Performance (2020/21)**

- 4.1 At 31 December 2020 the Pension Fund's internally managed cash, including balances held in EUR/USD bank accounts, amounted to £156m (£121.1m at 31 March 2020). Internally managed cash balances currently held by the Fund remain high pending the implementation of its strategic allocation decision to move towards income focused assets (infrastructure and private debt via fund arrangements, with the potential total commitment being 10% of the total Fund value). Although money for such investments will be drawn over time, latest cash flow projections indicate that internally managed cash balances will be fully utilised during the second quarter of 2021/22. It therefore remains appropriate for the Fund to reserve cash (instead of passing surplus cash to the external fund managers) for this future investment to avoid additional trading cost and opportunity risk relating to any short-term investment.
- 4.2 During 2020/21 (to 31 December) the Pension Fund had an average internally managed investment balance, excluding foreign currency, of £164m (£105.5m for 2019/20; to 31 December 2019). Throughout the period investments were held in a Lloyd's business account and a series of short-term (AAA credit rated) Money Market Funds. The increase in the average internal investment amount during 2020/21 is mainly a consequence of West Sussex County Council paying over 2020/21 employer contributions as a lump sum payment in April 2020 (£44.4m) and the Pension Fund's continued approach of not passing surplus funds on to the external cash managers (see paragraph 4.1).
- 4.3 The Director of Finance and Support Services confirms that there were no breaches of the approved 2020/21 Treasury Management Strategy regarding internally managed cash during the period 1 April 2020 to 31 December 2020. The Director of Finance and Support Services further confirms that in addition to balances held for investment, foreign currency (EUR/USD) balances were

held in attempting to achieve the most beneficial rates when exchanging back into Sterling.

- 4.4 At 31 December 2020 the total amount of foreign currency held was valued in GBP at £9.2m (based on 31 December exchange rates as provided by Northern Trust):

<b>Bank Account</b>	<b>Balance at 31/12/20</b>	<b>Average Balance</b>
Lloyds - Euro Account	€1.359m	€1.599m
Lloyds - US Dollar Account	\$10,896m	\$4.211m

- 4.5 In accordance with the investment strategy approved in January 2020 (internally managed cash balances) the Pension Fund received interest totalling £0.05m during the period 1 April 2020 to 31 December 2020 (£0.5m for 2019/20; to 31 December 2019). The rate of return achieved on GBP balances held during the period was 0.04% (0.66% during the same period in 2019/20) reflecting the ultra-low interest rates applicable on instant access GBP investments.

<b>Counterparty</b>	<b>Average Balance £'m</b>	<b>Interest Received £'m</b>	<b>Rate of Return %</b>
Lloyds-Current Account (GBP)	85.3	-	-
Short-Term Money Market Funds	78.7	0.05	0.09
<b>Total (i)</b>	<b>164.0</b>	<b>0.05</b>	<b>0.04</b>

(i) Additionally, interest totalling \$15,008 (£10,979 at 31 December 2020) has been received in respect of cash balances held in the Pensions Fund's USD bank account (no interest received in respect of EUR balances held).

- 4.6 During the same period West Sussex County Council achieved a rate of return of 0.82% on its invested cash balances. The higher yield reflects the Council's treasury management strategy of investing a proportion of its cash balances for periods up to 365 days and beyond (including long-term externally managed pooled investment funds) at interest rates higher than those available on the instant access accounts used by the Pension Fund.

## **5. Risk implications and mitigations**

- 5.1 Covered in main body of report.

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### **Appendices**

Appendix A – Treasury Management Strategy (2021/22)

### **Background Papers**

None